

# ICPS newsletter

## Market Reforms Struggled in 1998

*"Last year was a year of lost opportunities for Ukraine because market reforms did not take place. This was the case because the government did not reform the economy since that conflicted with its interests. Economic crisis can weaken those supporting the status-quo and unite supporters of the reforms." This explanation was derived during this year's first weekly macroeconomic seminar held on January 12 at the International Centre for Policy Studies. Yet the following issues remained undecided: whether the government knew how to carry out reforms and who supported the status-quo.*

### Expectations of a breakthrough were unrealistic

Head of the Economic Analysis Division of the Ministry of Economy of Ukraine Mr Evgen Frolov characterised the year 1998 as a year of expectations that did not come true. Ukraine's economy did not perform up to the government's targets — growth of GDP by 0.5% and industrial output by 1% compared with 1997. To Mr Frolov's mind, reasons having broken the positive developments of the end of 1997 — first half of 1998 were the world financial crisis, the government's inability to stabilise the state finances including reduction of the fiscal deficit and increase in money inflows to the state budget, and to carry out the administrative reform which could have optimised the state economic policy.

According to the forecast prepared by the experts from the Ministry of

Economy, the GDP will reduce by 1% YOY in 1999, reduction continuing for three quarters in a row and growth beginning in the fourth quarter. Inflation will equal 20%. If main macroeconomic targets are reached, the government predicts macroeconomic stability at the end of 1999 and economic growth in the year 2000.

Chief economist of the International Centre for Policy Studies, the Quarterly Predictions project co-ordinator Mr Vasyl Yurchyshyn contradicted to Mr Frolov by saying that the forecast for 1998 prepared in the Ministry of Economy had been too optimistic and absolutely unattainable. Failure to fulfil economic reforms meant that Ukraine had no chances to finish the year 1998 with positive economic results. Mr Yurchyshyn emphasised that positive improvements in the economy at the beginning of 1998 provided a chance for carrying out market reforms but the government did not take advantage of

### Last week

#### The First Economic Seminar

**in 1999.** The First Tuesday Macroeconomic Seminar took place in the Centre on January 12. It was devoted to the economic results of Ukraine in 1998.

**The Second Stage of the Country Economic Memorandum Project.** The Ministry of Economy of Ukraine and the World Bank decided to continue their co-operation with the ICPS under the Country Economic Memorandum Project.

Within the first stage of the Project, Ukrainian experts worked out analytical reports onto 8 main directions of economic policy. Numerous discussions helped settle the position of the Ukrainian side with that of the experts from the World Bank. Transition to the second stage will mean further research and discussions as well as transfer of the results to the public and active political discussion in the government.

Within the second stage, the Centre announces competition for positions of project co-ordinators for each of the 8 directions of the Country Economic Memorandum Project.

Our requirements to applicants include:

- Higher education;
- Fluency in Ukrainian and English;
- Research and management experience;
- Experience in collaboration with government and non-governmental experts, enterprises.

Applicants are asked to forward their resumes to the ICPS or by e-mail: [SLoboyko@icps.kiev.ua](mailto:SLoboyko@icps.kiev.ua).

### Ukrainian economy in 1998

*The year 1998 turned out another unimpressive year for the economy of Ukraine. Thus, GDP in real terms fell by 1.2% during 11 months of 1998 compared with the corresponding period of 1997. The amount of GDP is expected to contract by 1.5–2% YOY. Industrial output was down 1.6% during 11 months of 1998 compared to the corresponding period of 1997.*

*The deficit of the state budget amounted to 1.6% of GDP during 11 months of 1998, with revenues equal 26.7% of GDP next to 28.7% in the first half of 1998.*

*The money supply in real terms remained roughly the same in 1998. The monetary base grew by 21%, broad money (M2) increased by 25%. The CPI (inflation) was up 20% YOY.*

*The hryvnia devalued by 80.5% during 1998. The NBU lost \$1.6 billion in foreign exchange reserves in 1998, the amount of the reserves equal about \$0.9 billion as at the end of the year.*

*More than 50% of all industrial and about 90% of agricultural enterprises recorded losses in 1998. Mutual arrears of enterprises increased. The total amount of debt payable exceeded the annual GDP. Barter accounted for 40–45% of total sales of all the enterprises.*

**The Centre Has Become a New Publisher of the Russian Version of the Transition.** The World Bank has chosen the International Centre for Policy Studies as its new contractor for publishing the Russian version of its newsletter about reforming economies the Transition. The Transition is published once in two months and is distributed in all the countries of the former Soviet Union. The last but one week saw the first issue prepared by the ICPS coming into circulation. To receive this issue and all the following ones please write to [marketing@icps.kiev.ua](mailto:marketing@icps.kiev.ua).

## ***This week***

**Discussion of the Economic Forecast for 1999.** The economic forecast prepared by the Quarterly Predictions group is to be discussed at the macroeconomic seminar on Tuesday, January 19. Key items of the discussion will be the following:

- Are there any factors of economic stabilisation in 1999?
- What impedes the collaboration of Ukraine with the World Bank and the IMF?
- What can happen to Ukraine if it is denied external loans?
- Possible scenarios of economic development of Ukraine in 1999.

**Discussion of the Money Laundering Issue.** On Friday January 22, the Centre will host the discussion of the Draft Law of Ukraine on Opposing the Legalisation of Money and Property Obtained Illegally. Co-organisers — Ukrainian Legislation Institute of the Ministry of Justice of Ukraine and the Embassy of the USA in Ukraine. For further information contact Vasyl Lashchivsky ([VLashchivsky@icps.kiev.ua](mailto:VLashchivsky@icps.kiev.ua)).

**New Publication of the Centre — the Policy Studies.** The first issue of a new publication of the International Centre for Policy Studies is about to become available. The new weekly publication is entitled the Policy Studies. It presents research and analysis of the state policies done by our experts and research institutions. The first issue is devoted to the problem of paralysed enterprises. An electronic version of the Policy Studies can already be ordered at [qp@icps.kiev.ua](mailto:qp@icps.kiev.ua), to subscribe for a hard copy contact [marketing@icps.kiev.ua](mailto:marketing@icps.kiev.ua).

that. So the year 1998 Mr Yurchyshyn characterised as a year of lost opportunities.

Mr Yurchyshyn stated that the world financial crisis was only a trigger of negative processes within the economy of Ukraine caused by the government's economic policy first of all at the micro-level. He also emphasised that administrative reform fulfilled by the government itself would not lead to positive results. Mr Yurchyshyn said that the forecast for 1999 prepared by the experts of the Quarterly Predictions group will be much more pessimistic than that from the Ministry of Economy of Ukraine.

## **Reduction of the government's role in the economy as a road to growth**

Chief economic adviser to the head of the National Bank of Ukraine Mr Victor Lysytsky said that no positive changes in economic situation were possible until the immense tax burden was relieved from Ukrainian companies. To Mr Lysytsky mind, the taxes that posed the biggest obstacle to business activity in Ukraine were the value-added tax and the payroll tax as shown by recent surveys.

Mr Lysytsky also emphasised the importance of elimination of barriers for money transactions by the enterprises including liquidation of restrictions on opening accounts with commercial banks, elimination of kartoteka #2 and prohibition of indisputable withdrawal of money from current accounts of companies. These barriers pushed enterprises out of the money economy; reduced the demand for money; created conditions for spread of barter, growth of mutual arrears and crisis of non-payments which eventually caused decrease in revenues of the state budget, increase in the fiscal deficit and intensification of the indebtedness crisis. Under such circumstances, fulfilment of the approved budget for 1999 with planned consolidated revenues at UAH 34.5 billion seemed unrealistic whatsoever and this step would lead to inevitable crisis of state finances.

Chief economist of the World Bank Office for Ukraine Mr John Hansen expressed the common opinion of foreign experts

who participated in the seminar. Mr Hansen emphasised the burning need for an all-round market reform to be carried out in Ukraine which had to include:

- Reduction of the government's role in the economy which included (a) reduction of a share of GDP redistributed through the state budget (i. e. cuts in taxes and state expenditure), and (b) cessation of direct interference with the economic activities of enterprises;
- Swift privatisation;
- All-round reform in agricultural sector and land reform;
- Deregulation and creation of favourable conditions for entrepreneurship;
- Implementation of hard budget constraints for enterprises by means of introduction of efficient contract enforcement and bankruptcy mechanism.

## **Economic crisis cleared the way for reforms**

Participants of the seminar expressed different opinions concerning the possibility of radical reforms which could reduce the wealth of the electorate in the short-run during the year of presidential elections. Fellow of Harvard Institute for International Development Mr Alexander Pyvovarsky stated that various groups interested in preserving the status-quo and opposing reforms existed within the society. Mr Pyvovarsky emphasised that such people were well organised while reformers were lacking common platform. Under these conditions Mr Pyvovarsky said that it was the economic crisis that could provide the only possibility to carry out market reforms through weakening their opposition.

Director of the International Centre for Policy Studies Mrs Vira Naniivska expressed the opinion that counting on economic crisis could hardly be a good position — it was important the reasons for the existence of the present system of interests be analysed and the understanding of how reforms should be carried out and why the reforms were necessary be embedded into the government and the society. She said that there was a need for reforms within the society and the task was to persuade the public that the reforms were necessary and try to unite their supporters.